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VIRGINIA BUSINESS REPORT

Note: There will be no December issue.

BUREAU OF BUSINESS RESEARCH, SCHOOL OF BUSINESS ADMINISTRATION
THE COLLEGE OF WILLIAM AND MARY, WILLIAMSBURG, VIRGINIA
Report No. 294 **November, 1984**

Business in Virginia, October, 1984 Data

Eleven issues of this Report *are published annually. Our policy this year was to publish issues in January through November, including for the first time a July issue. There will be no December issue, so the next* Report *will be the January, 1985 review of the past year. In the meantime, we hope all of our readers enjoy a Merry Christmas and a Happy New Year.*

Virginia's economic indicators clearly are showing the signs of renewed higher growth in consumer spending. After the slow pace in July and August, Virginia's general taxable sales rose by 17.3 percent in September 1984 compared to last September. Our more limited retail sales sample indicates the upturn in growth continued in October: the sample showed an increase of 9.9 percent in October, up 2.7 percentage points from the 7.2 percent rise in September. Durable goods demand in October also accelerated, with new car registrations up 21.9 percent over a year ago, compared to a 17.7 percent gain in September. Virginia consumers in nearly all parts of the Commonwealth are buying at higher rates, rates which are more in line with the continued recent growth in their personal income. Therefore the outlook is for Christmas retail sales to be strong, with a double-digit increase likely over the record sales levels of last December.

Chart I
Nine Selected Business & Economic Indicators Percentage Change

Percentage Change October, 1984 from October, 1983

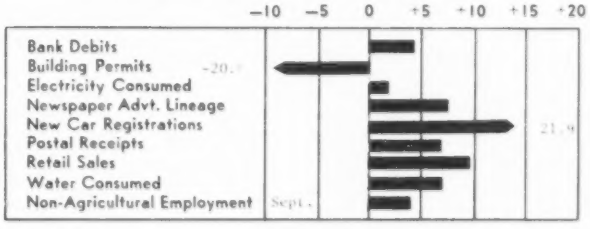
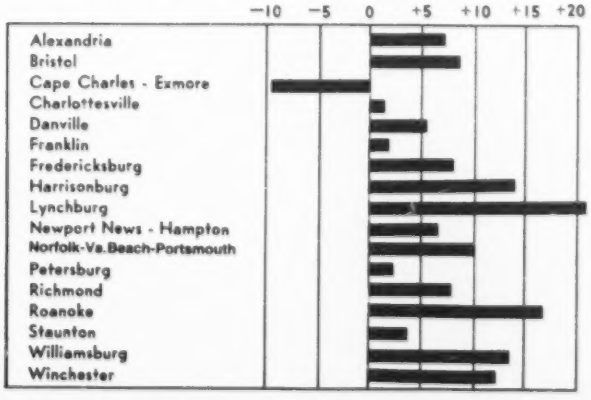


Chart II
City Indices

Percentage Change October, 1984 from October, 1983



The employment developments also have been encouraging. In September, nonagricultural employment Statewide was 4.1 percent above a year ago. By comparison, the national increase from September 1983 to September 1984 was a much lower 1.2 percent. We also have just received the Virginia Employment Commission's October employment release, which showed only a slightly lower gain of 3.9 percent compared to October of 1983. Thus Virginia's employment growth has held up very well through the third quarter of 1984, far better than the national performance. November, and especially December, are likely to show slower growth, as the continued rise in retail trade and services employment is partially offset by declining employment in many of Virginia's manufacturing industries. Temporary layoffs in manufacturing industries in many parts of the State will dampen the holidays for a sizable number of Virginians. So, our general good economic health will not be shared by all as the year ends. However, the outlook for the spring, as discussed in more detail in our second article, is for continued strength in consumer demand nationally to lead to a resurgence in factory orders. Hopefully by February these new orders will lead to higher growth in Virginia's manufacturing employment, giving us renewed employment growth generally throughout the Commonwealth.

Building permit activity did decline in October, pointing to a year-end pause in the level of construction in many cities around the State. And, even with the recent fall in interest rates, building permits in the spring are not likely to match the exceptional levels of early 1984. However, this industry should regain some strength in the first quarter, adding to the gains expected in retail businesses and manufacturing. Virginia still is demonstrating above-average economic vitality, and should begin the new year with a first quarter which shows more vigor than the fourth quarter of 1984.

RLP

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SELECTED BUSINESS AND ECONOMIC INDICATORS FOR 17 CITIES

TABLE I October, 1984

Monthly Index Number Comparisons of Current Month to Same Month in Base Period (1977) - Base Period = 100

CITY	CITY INDEX*	BANK DEBITS*	BUILDING PERMITS	ELECTRICITY CONSUMED	NEWS-PAPER ADV LINAGE	NEW CAR REGIS-TRATIONS	NON AGRI-CULTURAL EMPLOYMENT#	WATER CONSUMED	RETAIL SALES †	POSTAL RECEIPTS
The State		268.1	146.3	110.1	105.7	217.8	121.7	92.7	153.9	279.1
Alexandria	143.9	232.0	111.2	107.9	N.A.	105.2	394.6	97.3	154.9	N.A.
Bristol	124.8	31.8	153.5	81.1	74.0	80.4	102.6	98.6	152.6	299.5
Cape Charles - Exmore	103.4	62.8	170.6	100.3	N.A.	64.2	N.A.	N.A.	103.6	186.0
Charlottesville	195.3	376.9	129.6	108.8	N.A.	102.0	99.2	119.2	193.8	274.2
Danville	140.0	N.A.	95.8	114.3	129.0	90.2	101.7	91.0	161.6	210.7
Franklin	120.5	N.A.	60.7	100.5	124.0	67.2	N.A.	102.0	123.4	200.2
Fredericksburg	166.6	181.4	235.7	N.A.	152.0	131.5	N.A.	62.8	152.7	346.9
Harrisonburg	139.8	49.8	379.3	N.A.	135.3	86.6	N.A.	131.5	154.5	251.5
Lynchburg	211.9	287.5	152.9	105.5	N.A.	100.5	99.2	124.2	160.2	596.8
Newport News - Hampton	127.7	195.5	239.8	95.0	81.8	84.6	66.3	120.6	148.1	N.A.
Norfolk - Va. Beach - Portsmouth	169.6	361.8	190.4	119.7	97.0	91.1	87.1	72.4	204.8	N.A.
Petersburg	101.2	2.1	101.7	N.A.	47.3	63.7	98.6	94.0	136.0	194.4
Richmond	152.4	240.0	89.4	126.3	122.6	94.0	117.2	120.6	140.2	247.1
Roanoke	175.7	430.6	235.9	88.7	155.7	73.2	109.3	96.1	159.8	257.7
Staunton	123.5	127.4	85.0	N.A.	82.7	88.2	N.A.	N.A.	116.8	215.9
Williamsburg	149.6	174.0	137.4	141.7	N.A.	102.5	N.A.	104.8	121.8	308.3
Winchester	161.5	266.9	83.5	118.6	195.3	104.7	N.A.	145.9	124.1	250.0

TABLE II October, 1984

Percentage Change from same month last year

CITY	CITY INDEX*	BANK DEBITS*	BUILDING PERMITS	ELECTRICITY CONSUMED	NEWS-PAPER ADV LINAGE	NEW CAR REGIS-TRATIONS	SEPT. NON AGRI-CULTURAL EMPLOYMENT#	WATER CONSUMED	RETAIL SALES †	SEPT. RETAIL SALES ‡
The State		4.1	-20.6	1.7	7.5	21.9	4.1	7.0	9.9	17.3
Alexandria	7.1	17.0	-86.1	-2.1	N.A.	16.0	5.9	6.0	7.6	23.9
Bristol	8.4	-12.2	-46.9	0.7	-2.2	6.3	5.2	10.1	14.7	23.3
Cape Charles - Exmore	-9.7	-9.8	-13.6	0.4	N.A.	-3.7	N.A.	N.A.	-15.0	-2.6
Charlottesville	1.2	33.6	-31.0	3.9	N.A.	0.6	0.3	1.1	0.6	15.5
Danville	5.2	N.A.	19.0	3.4	20.0	12.2	-0.2	4.4	-1.2	9.6
Franklin	1.9	N.A.	126.2	0.3	2.6	-16.3	N.A.	-8.1	11.6	20.9
Fredericksburg	7.8	-57.2	210.2	N.A.	12.5	17.0	N.A.	10.1	2.4	49.5
Harrisonburg	13.4	69.7	143.9	N.A.	14.7	64.3	N.A.	-5.3	2.2	3.8
Lynchburg	20.8	2.4	-49.7	1.9	N.A.	33.9	2.3	1.2	29.2	26.4
Newport News - Hampton	6.5	8.4	-3.4	0.4	0.4	19.2	6.4	5.4	6.8	15.4
Norfolk - Va. Beach - Portsmouth	10.0	-0.4	2.7	5.5	15.8	15.9	5.4	2.4	10.2	13.6
Petersburg	2.2	25.9	581.0	N.A.	-19.7	3.8	-0.5	-5.5	11.5	13.1
Richmond	7.6	4.5	-78.3	3.0	2.6	-1.5	2.2	20.5	9.5	15.8
Roanoke	16.8	5.1	536.3	2.9	9.7	30.2	3.9	-3.9	26.2	29.0
Staunton	3.5	55.6	43.0	N.A.	-0.3	48.0	N.A.	N.A.	-10.0	6.8
Williamsburg	13.7	101.4	22.8	5.6	N.A.	57.1	N.A.	9.6	3.2	3.1
Winchester	12.2	29.1	-28.0	5.0	6.7	33.1	N.A.	29.0	3.8	12.2

TABLE III

Percentage Change January - October from same period last year

CITY	CITY INDEX *	BANK DEBITS*	BUILDING PERMITS	ELECTRICITY CONSUMED	NEWS-PAPER ADV LINAGE	NEW CAR REGIS-TRATIONS	JAN.-SEPT. NON AGRI-CULTURAL EMPLOYMENT #	WATER CONSUMED	RETAIL SALES †	JAN.-SEPT. RETAIL SALES‡
The State		1.8	15.9	5.1	11.5	18.4	4.2	2.0	8.8	19.7
Alexandria	9.0	25.1	-6.8	1.1	N.A.	14.7	5.5	2.1	12.0	24.7
Bristol	16.0	-3.8	42.6	6.8	-1.0	22.4	4.0	16.3	22.6	17.6
Cape Charles - Exmore	0.2	39.1	59.9	-3.1	N.A.	26.3	N.A.	N.A.	-7.4	13.5
Charlottesville	2.4	26.0	88.7	6.8	N.A.	12.9	1.5	-3.3	-0.7	20.4
Danville	6.5	N.A.	76.4	2.5	14.4	14.5	1.4	2.4	4.0	16.1
Franklin	6.2	N.A.	-28.9	3.0	4.6	24.9	N.A.	-9.0	6.6	18.8
Fredericksburg	11.4	-15.1	16.9	N.A.	8.6	32.6	N.A.	0.6	8.9	41.2
Harrisonburg	9.1	46.2	68.9	N.A.	11.2	15.8	N.A.	2.1	8.5	22.6
Lynchburg	13.3	-19.4	-21.6	4.2	N.A.	17.9	3.4	4.2	17.8	20.9
Newport News - Hampton	6.2	7.8	45.6	4.9	12.4	21.2	5.2	-1.4	2.2	15.1
Norfolk - Va. Beach - Portsmouth	10.1	-1.0	11.7	7.0	13.8	18.3	5.0	5.2	8.7	18.5
Petersburg	1.5	-6.8	3277.9	N.A.	-8.8	14.0	-1.7	-7.5	3.7	13.1
Richmond	9.5	2.2	-8.9	9.5	12.3	24.5	2.6	1.4	6.2	17.6
Roanoke	13.1	3.1	33.4	7.6	13.1	19.8	3.4	0.2	17.1	21.2
Staunton	5.3	33.7	14.1	N.A.	3.2	25.8	N.A.	N.A.	-0.8	7.9
Williamsburg	7.0	32.2	63.4	6.2	N.A.	20.4	N.A.	8.6	2.3	14.3
Winchester	9.3	15.0	-9.1	9.4	16.6	18.8	N.A.	11.3	3.1	29.9

*Computation of City Index is based upon a weighted arithmetic mean of all business and economic components listed except Building Permits and Bank Debits, which are excluded because of their highly erratic nature.
#Virginia Employment Commission data which lags behind current reports.
†Preliminary data based on a survey sample.
‡Revised data based on sales tax information which lags behind current reports.

N.A. - Not Available
0.0 - No Change

Table IV

Annual Rates of Change, Selected Periods

	Annual Rate of Change, 1982:4 Through 1984:2	Annual Rate of Change, 1984:3
Nation		
Real Gross National Product (1972$)	7.1%	1.9%
Inflation (GNP Implicit Price Deflator)	3.8	3.7
Current Dollar Gross National Product	11.2	5.6
Federal Government Spending	4.0	14.3
Gross Private Domestic Investment	40.6	23.1
Personal Consumption Expenditures	9.1	4.6
Personal Income	8.6	8.7
Nonagricultural Employment, Seasonally Adj.	3.7	3.1
Manufacturing Employment	4.7	2.0
Nonmanufacturing Employment	3.4	3.4
Virginia		
Personal Income	9.6%	N.A.
Nonagricultural Employment, Seasonally Adj.	5.0	N.A.
Manufacturing Employment	3.4	N.A.
Nonmanufacturing Employment	5.4	N.A.

The Expansion, Retrospect and Prospect

The second anniversary of the current economic expansion is an appropriate time to review our past performance and look ahead to 1985. Table IV provides the annual rates of change for selected national and Virginia economic series, from the trough of the recession in the fourth quarter of 1982 (1982:4) through the second quarter of 1984 (1984:2). During that period we achieved very high growth. Then, as all of you are aware, the nation's growth slowed dramatically in the third quarter of 1984. Therefore for comparison, the 1984:3 annual rates of change are shown in a separate column in the table. What happened, and what will happen next? We will consider the national situation first, and then turn to Virginia.

The Nation

For the first six quarters of the expansion, the nation's real Gross National Product (GNP), our physical output of goods and services, grew at an annual rate of 7.1 percent. That is the highest real growth since the early 1950's, and a rate of growth we could not sustain much longer without overheating. A slowdown was expected, but in the third quarter the annual rate of growth fell to only 1.9 percent in real terms. Why such a dramatic slowdown? The growth rates in Table IV offer a perspective. Federal government spending was not the answer. For six quarters it had grown at an annual rate of only 4.0 percent in current dollars, only slightly more than the inflation rate. Its growth began accelerating this year, and in the third quarter of 1984 Federal spending was growing at a 14.3 percent annual rate. Looking elsewhere, rising interest rates in the spring and summer did slow substantially the growth of Gross Private Domestic Investment, especially the residential housing component. But, overall private investment still grew at an annual rate of 23.1 percent in the third quarter, a very high rate.

The real source of the dramatic slowdown in the third quarter was the slower growth in consumer spending. During the first six quarters of the expansion, personal consumption expenditures grew at an annual rate of 9.1 percent. That rate was higher than the 8.6 percent annual growth in personal income. Consumers could not continue indefinitely to increase their spending more rapidly than their income was growing, so a lower rate of consumption was expected soon. The big question was when, and by how much, would consumption slow down? In the third quarter we got the answer. Consumer spending grew by only 4.6 percent. The drop from 9.1 percent growth to 4.6 percent may not seem so large, but remember that consumption accounts for 65 percent of the nation's total demand. Therefore, even small changes in consumption growth have a large impact on total demand. Plus, the third quarter growth of only 4.6 percent was just slightly higher than the inflation rate, so in real terms consumer demand became flat. That caused businesses to quickly cut back their orders for consumer goods, and industrial production also has levelled off in recent months. The slower growth which resulted also reduced the demand for money, pushing down the money supply growth and interest rates.

With that background, what is the outlook for the first half of 1985? That depends primarily on two factors: what will consumers do, and what will the Federal Reserve System's monetary policy be? Government spending still is growing, and moderate growth in private investment spending can be expected if the consumer spending growth rebounds and adequate money is available to meet total demand without pushing up interest rates.

Turning first to consumers, Table IV shows their personal income continued to grow at a high annual rate, 8.7 percent, in the third quarter. Therefore income still is growing at a rate which will enable consumer spending to accelerate. Will it? An intangible which implies the answer is yes is consumer confidence about the future. Consumer confidence remains at the highest levels since 1966, and actually rose in October. Their confidence has not been shaken by the recent slowdown, the doubts of economists and financial analysts, or the rhetoric of the recent political campaigns. Therefore consumers have the income, credit capacity, and the confidence to want to buy in the future. Our view is the third quarter slowdown in consumer spending was just a temporary and overdue pause. For December and the first half of 1985, consumer spending growth should increase to at least an eight percent annual rate, about twice the third quarter rate.

That consumer rebound will be the key to first half growth in 1985. Business inventories are *not* excessive, in spite of an unplanned increase in the third quarter. Private business inventories as a percent of monthly sales still are at their lowest levels since 1973. Therefore increased growth in consumer spending very quickly will lead to new orders for consumer goods, causing the nation's real output to grow more rapidly by the middle of the first quarter of 1985.

The other necessary ingredient for a national rebound in the first half of 1985 is a more accomodating monetary policy. Not a flood of money. But, sufficient monetary growth for the public to carry out its spending plans without pushing up interest rates. The Federal Reserve System recently has given every indication that it wants to meet this need. We believe the Federal Reserve System will achieve its goal of a higher, more stimulative rate of monetary growth in the coming months, enabling interest rates to continue to decline modestly even as spending rebounds.

In sum, the prospects are that consumer, investment, and government demand will be higher in the first half of 1985. The nation not only will have the demand, but also the production capacity and monetary growth to achieve an annual real growth rate of 4 percent in the first half of 1985. And, inflation also can be expected to remain in the 4 percent annual range. Thus we expect a very satisfactory first half performance.

What about the second half of 1985? That depends more on the President and Congress than on the private sector. The private sector has been running uphill with two burdensome weights — the Federal deficit and the trade deficit. We handled these weights very well in the first six quarters of the expansion. But, as we climb higher, the weights are growing. The Federal deficit in fiscal year 1984 was $175 billion, and it now is expected to be over $200 billion for 1985. Similarly, our net merchandise trade balance so far in 1984 has been running at a deficit of $113.2 billion at an annual rate, and could go higher in early 1985.

All of you have heard throughout the past two years why the Federal deficit is a long-run problem which requires action. However, the deficit for fiscal year 1986 is a *short-run* problem, too. Without some clear action by the President and Congress by the summer of 1985, the uncertainty and more pessimistic outlook generated are likely to produce a drop in consumer and business confidence, bringing the expansion to a halt. *Clear* action to reduce the deficit does not have to be *massive* action. In fact, it *cannot* be massive — a Federal policy swing of over $200 billion in the tax and spending mix in one year *also* would bring the expansion to a halt. What we expect, and hope for, are changes which will reduce the deficit by up to $50 billion in fiscal year 1986. Exactly what those changes will be no one knows. Tax reform is the issue which holds the headlines right now. Tax reform is desirable, and even a revenue-neutral version could provide some improvement in fiscal year 1986. But, that issue must not be allowed to obscure the need for, and action on, a deficit reduction program. Here, some compromises will be necessary, to achieve the needed deficit reductions. And, these compromises are likely to include some increases in business taxes, if not individual income taxes. The *sooner* something is done, so the public *knows* what lies ahead, the better chance we have of extending the recovery through the second half of 1985 and into 1986.

The trade deficit is another problem which is slowing U.S. real growth, as it siphons off demand for domestically produced goods. As our growth slows, so will the trade deficit. But to increase the percent of income spent domestically, the value of the dollar must decline. The strong value of the dollar which has encouraged the very high growth of imports probably has peaked. Our lower real growth, with modest easing of interest rates, should produce a moderate decline in the value of the dollar in 1985.

The Federal deficit action, monetary policy, and a lowered value of the dollar all are interrelated. A lower dollar value requires more domestic saving and money growth. That saving must partly be produced by the Federal government through some deficit reduction. The deficit reduction also is necessary to give the Federal Reserve System sufficient room to maneuver in the second half of 1985 in providing adequate monetary growth. So, Congressional action to achieve a deficit reduction program by mid-1985 is crucial to avoiding higher interest rates and near zero real growth in the second half of 1985.

We remain optimistic that Congress will take appropriate action. If so, real growth at an annual rate of approximately 3 percent in the nation's output is likely in the second half of 1985. That performance not only will yield year-over-year real growth of about 4 percent, but it also will give the nation the opportunity to continue the expansion into 1986.

Virginia

Let us turn briefly to the outlook for Virginia. In 1985, the Commonwealth will grow at a higher rate than the nation. For some reasons why, please take another look at Table IV and compare Virginia's performance to the nation's during the present expansion. We were in better shape economically than the nation in the fourth quarter of 1982, and yet during the first six quarters of expansion we outgrew the nation by nearly every measure.

Personal income is a major example. The annual rate of increases for the nation was 8.6 percent, but Virginia's personal income grew at a 9.6 percent annual rate. That is not an unusual result. Virginia has a history of more stable growth than the nation. But, it also has a history of more *rapid* growth than the nation, both in the recent past and over the longer term going back at least to 1968. When the nation's personal income rises, our personal income tends to rise even more rapidly. The growth in nonagricultural employment during the expansion shows the same pattern. Seasonally adjusted, Virginia's employment grew at a 5.0 percent annual rate, compared to the national rate of 3.7 percent.

The strength behind our growth is shown by examining the employment growth by type, in Table IV. Nonmanufacturing employment in Virginia accounts for 82 percent of the State's employment; and the Commonwealth achieved a seasonally adjusted annual rate of growth of 5.4 percent in nonmanufacturing employment. The national growth rate was only 3.4 percent. Therefore the State's primary strength in the expansion has been in the monmanufacturing sectors, predominantly wholesale and retail trade and services.

For 1985, the national outlook is for trade and service employment to grow considerably more rapidly than manufacturing employment. That is the result of slower growth in business equipment purchases and consumer durable goods demand, with more growth centered in consumer demand for nondurable goods and services. Virginia can be expected to follow that pattern, too, with continued substantial growth in the trade and services sectors. In manufacturing, Virginia's employment growth should at least match the national growth, particularly in the second half of 1985, because of our industrial mix.

Pulling together all of these factors, our prediction is Virginia personal income will grow in the 10 percent range in 1985, with nonagricultural employment growth of about 2.5 percent. Those results will mean one more year in which we outperform the nation.

RLP